As of March 1, 1954, pursuant to the plan of reorganization as implemented by the consummation order and final decree entered by the District Court on February 26, 1954, the petitioner acquired all of the property, business, rights, privileges and franchises of predecessor, free and clear of all claims, liens and encumbrances, with certain exceptions. The petitioner was required to assume, and did assume, *inter alia*, predecessor's liability for Federal taxes, all claims against predecessor entitled to priority over its respective mortgages, and obligations of more than $5,000,000 for conditional sales agreements and equipment trusts. Bonded indebtedness of predecessor under three different mortgages, totaling approximately $56,500,000, was not assumed by the petitioner, but was discharged through issuance of new bonds, totaling approximately $35,000,000, and new common stock. Unsecured claims aggregating about $9,000,000 were not assumed, and the interests of the preferred and common stockholders of predecessor, of par value totaling approximately $27,000,000, were eliminated. Since March 1, 1954, the petitioner has operated as a common carrier by rail. (Pet. 16a-18a)

The net income of predecessor for the calendar year 1953 was $522,656.84 before the allowance of any net operating loss deduction. The petitioner's first taxable period began March 1, 1954, and ended December 31, 1954, and for that period the petitioner had a net operating loss in an amount sufficient to eliminate all net income of predecessor for 1953, if allowed as a net operating loss carryback to 1953. (Pet. 18a) In the proceedings below, the Court of Claims held that such a loss carryback, which the petitioner asserted should be allowed, was properly disallowed by the Commissioner. (Pet. 14a)

REASONS FOR GRANTING THE WRIT

1. As the successor corporation in the bankruptcy reorganization of a railroad, the petitioner acquired the business, franchises, and properties of the debtor and continued the debtor's operations as a common carrier by rail. Among the substantial liabilities of its predecessor assumed by the petitioner was the liability of the predecessor for all taxes due the United States. In the instant case, the Court of Claims has held that, although the petitioner inherited the tax liabilities of the corporate enterprise for prior years, it did not inherit the right to offset income for those years by the carryback of post-reorganization net operating losses. In so holding, the Court of Claims has erroneously laid down a new, special rule that bankruptcy reorganizations of railroads—alone among all the types of corporate readjustments which Congress has recognized in the 1939 and 1954 Codes as mere modifications of a continuing enterprise—result in the creation of a new "taxpayer" and the severance of the old corporation's carryover and carryback rights.

2. This decision overrules a 1958 decision by the same court; it is in conflict with the rationale of recent decisions by this Court and appellate courts; and it singles out railroads for discriminatory treatment without legal justification, and thereby raises a question of Federal law of considerable magnitude, not heretofore passed upon by this Court. Moreover, the grounds upon which the Court of Claims reached its decision are in square conflict with a landmark decision of this Court universally recognized as good law today.

3. In *Libson Shops, Inc.* v. *Koehler*, 353 U.S. 382, this Court invoked the legislative history of the carryover and carryback provisions as revealing that Con-

gress was concerned with ameliorating the tax consequences of fluctuations in income of a single business. Hence, this Court held that only if a given business enterprise survives corporate readjustments as the same business is it entitled to carry back or carry over its losses across the line of reorganization. In *Libson Shops*, this requirement was not met, since the post-reorganization business was an amalgam of 16 separate pre-reorganization enterprises. However, by way of contrast, this Court took occasion to cite recent decisions by the Court of Claims and several Courts of Appeals, wherein carryovers and carrybacks across the line of reorganization were sustained, as cases where the courts properly took the view that the post-reorganization corporation was the same "taxpayer" as its predecessor because it continued to conduct the same business enterprise.

4. The appellate decisions thus cited with approval all involved reorganizations which qualified as mergers under applicable state law. However, in the light of *Libson Shops*, the First Circuit has held that the technical requirements of a merger are irrelevant; that the identity of a continuing business enterprise as a "taxpayer" survive all those corporate readjustments which, by the nonrecognition provisions grouped in Section 112 of the 1939 Code, Congress has viewed as effecting no significant change in the identity of a corporate taxpayer. *Donovan, Inc.* v. *United States*, 261 F. 2d 470. Thus, the decision below is at variance with the result reached by the Court of Appeals for the First Circuit in the *Donovan* case.

5. In the instant case, the bankruptcy reorganization did not interrupt, or even modify, the business of common carrier by rail conducted by the predecessor and

continued by the petitioner with the same operating assets. The Court of Claims' holding that the bankruptcy reorganization created a new "taxpayer" for purposes of the carryover and carryback provisions is contrary to the rationale of *Libson Shops;* moreover, the court's reasoning betrays a misreading of that decision, and brings the court into square conflict with *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U.S. 179. The Court of Claims reads *Libson Shops* as requiring, for the requisite continuity of business enterprise, not only a continuity of business operations and assets but a substantial continuity of the same equity ownership; hence, it holds that the issuance of the petitioner's stock to creditors of its predecessor terminated the "taxpayer" identity of the pre-reorganization enterprise. But the four corners of the *Libson Shops* opinion may be searched in vain for any requirement that the ownership of a business enterprise must remain the same. There is no such requirement in the carryover and carryback provisions, nor does it emerge from the legislative history of those provisions quoted in *Libson Shops*. To the contrary, the intent of Congress to ameliorate the tax consequences of fluctuations in the income of a business is fully as germane to a continuing corporate enterprise emerging from the vicissitudes of a bankruptcy reorganization as it is to an enterprise emerging from any other form of corporate readjustment.

6. The Court of Claims is equally in error, and comes into conflict with a decision of this Court, in holding against petitioner on the ground that bankruptcy reorganizations of railroads are not within the family of the so-called "tax-free" reorganizations. It may be questioned, indeed, whether the Court of Claims is sound in its premise, i.e., that only an enterprise

emerging from a "tax-free" corporate readjustment is entitled to the carryback and carryover privilege, because such a limitation is discernible in the legislative history of the "tax-free" provisions. For this proposition, the court relies upon its own broad characterization of Congressional intent in enacting the nonrecognition provisions, and even this characterization does not attribute to Congress any specific intent to mesh the non-recognition provisions with the carryover and carryback provisions. Assuming *arguendo* the soundness of this limitation, however, it is irrelevant here. Bankruptcy reorganizations, whether of railroads or other types of enterprises, have been among the family of "tax-free" corporate readjustments ever since the early enactment of the nonrecognition provisions. The Court of Claims' holding to the contrary is directly contradicted by the following:

a. The decision of this Court in *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U.S. 179, where this Court held that a bankruptcy reorganization, in which the creditors of the old corporation became the stockholders of the successor corporation qualified as a "reorganization" in the nature of a "merger or consolidation," under the 1928 Revenue Act definitions of a "reorganization," and hence qualified for nonrecognition treatment. This Court held explicitly (p. 184):

> The Pinellas Ice & Cold Storage case makes plain that "merger" and "consolidation" as used in the Act includes transactions which "are beyond the ordinary and commonly accepted meaning of these words." * * * *Insolvency reorganizations are within the family of financial readjustments embraced in those terms as used in this particular statute.* (Emphasis supplied.)

b. Thereafter, by Section 142(a) of the 1942 Revenue Act, Congress added to the nonrecognition provisions of Section 112(b) a new provision (subsection (b)(9)) specifically covering Section 77 bankruptcy reorganizations of railroads. At the same time, Congress added a correlative basis provision, Section 113 (a)(20), which provided for substitution of basis in bankruptcy reorganizations of railroads, just as substitution of basis was provided by other provisions of Section 113(a) for all other types of corporate readjustments covered by Section 112(b)—and with the same justification, i.e., that none of these readjustments was a taxable event, and therefore that basis remained unchanged.

In the face of this specific inclusion of railroad bankruptcy reorganizations in the family of corporate readjustments covered by the nonrecognition and correlative basis provisions, the Court of Claims insists that such reorganizations do not "meet the technical requirements of a tax-free reorganization" because Congress provided only for nonrecognition of loss, whereas all of the earlier provisions of Section 112(b) accorded nonrecognition to gain as well as loss. This narrow, admittedly technical distinction not only runs counter to the evident statutory scheme, and to this Court's declaration in *Asphaltic Limestone* that insolvency reorganizations are "within the family of financial readjustments" covered by the nonrecognition scheme, but clashes with obvious economic realities. Bankruptcy reorganizations are salvage operations; the purpose is to minimize and distribute equitably the *losses* that result. It cannot, then, be said that Congress meant to limit or set apart the nonrecognition status of railroad bankruptcy reorganizations. As

stated in 3 Mertens, Law of Federal Income Taxation, Sec. 20.80, "Presumably at the time the provision was first adopted the prospect of gain was only an academic possibility," and when Congress prospectively extended this provision, in the 1954 Code, to cover gains as well as losses, it was because of changed circumstances attending railroad reorganizations. See S. Rep. No. 1404, 84th Cong., 2d Sess., p. 2, where it is stated that: "It has been brought to the attention of the committee that there may be instances in such railroad reorganizations where the transfer of property * * * would result in a taxable gain."

7. The Court of Claims' decision applies, not to all bankruptcy reorganizations, but only to bankruptcy reorganizations of railroads; the court has singled out this category only, among all the corporate readjustments covered by the nonrecognition provisions, as failing to meet "the technical requirements of a tax-free reorganization" and as extinguishing the carryover and carryback rights of the predecessor—albeit the successor corporation is required to assume the tax liabilities of the predecessor. For reasons given above, this result is unsound and involves a conflict both with the rationale of *Libson Shops* and with the square holding of *Asphaltic Limestone Co.* Moreover, this highly discriminatory ruling against the railroad industry raises an important Federal question which this Court has not passed upon, and should resolve.

The possible application of the limitations prospectively imposed by Section 381 of the 1954 Code has no bearing on the importance of the question to this taxpayer and to other railroads similarly situated with respect to this and related issues. For example, the decision below has a direct bearing on the question

whether the earnings and profits of the predecessor road are to be carried over to the successor road.

Respectfully submitted,

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March 1962.

APPENDIX

APPENDIX

UNITED STATES COURT OF CLAIMS

No. 64-59

(Decided December 6, 1961)

[296 F. 2d 750]

WISCONSIN CENTRAL RAILROAD COMPANY

v.

THE UNITED STATES

Joseph M. Jones for the plaintiff. *Fordyce W. Crouch, Robert T. Molloy* and *Kenneth W. Moroney* were on the brief.

Benjamin H. Pester, with whom was *Assistant Attorney General Louis F. Oberdorfer*, for the defendant. *James P. Garland, Philip R. Miller* and *Mildred L. Seidman* were on the brief.

OPINION

JONES, *Chief Judge*, delivered the opinion of the court:

This is an action to recover $253,659.98 in income tax and $32,731.15 in interest paid by plaintiff as successor to Wisconsin Central Railway Company (hereinafter sometimes referred to as "predecessor") in a bankruptcy reorganization under section 77 of the Bankruptcy Act.[1]

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[1] 30 Stat. 544, as amended, 11 U.S.C. § 205 (1958 Ed.).

The facts are stipulated. Predecessor, a Wisconsin corporation which operated as a common carrier by rail, was in receivership from December 3, 1932, to September 30, 1944, and, from September 30, 1944, to March 1, 1954, was in trusteeship under a section 77 reorganization proceeding. Reorganization managers, designated pursuant to a plan approved by the Interstate Commerce Commission and the district court, decided that the reorganized company should be a new corporation organized under the laws of Minnesota, rather than a continuation of the old corporate shell with appropriate charter amendments. Plaintiff was thereupon organized and, as of March 1, 1954, pursuant to the district court's final decree, acquired all properties, but not all liabilities, of predecessor. Since that date, plaintiff has operated as a common carrier by rail.

As is pertinent, the consummation order and final decree provided as follows: All properties of predecessor were vested in plaintiff, and taken free and clear of all rights of predecessor's creditors and stockholders, except as otherwise provided in the decree. Plaintiff was required to pay all Federal taxes owing by predecessor. The consummation order and decree "otherwise provided" that plaintiff assume a considerable part of predecessor's liabilities, in addition to those for taxes. For example, it assumed obligation of more than $5,000,000 for conditional sales agreements and equipment trusts. Predecessor's bonded indebtedness, totaling approximately $56,500,000, was not assumed, but was discharged by the issuance of new bonds in the amount of $35,000,000 and shares of plaintiff's common stock. However, unsecured creditors (in the amount of $9,000,000) and all the old corporation's preferred and common stockholders (of par value totaling $27,000,000) were wiped out.

Predecessor had a net income for the calendar year 1953 for which plaintiff paid the income tax due. For plaintiff's

taxable year of March 1, 1954, to December 31, 1954, there was a net operating loss in an amount sufficient to eliminate all net income of predecessor, if allowed as a net operating loss carryback to 1953.

The single issue before this court is whether, under the rules of law developed with respect to the applicability of section 122 of the Internal Revenue Code of 1939[2] to tax consequences of a reorganization, plaintiff is entitled to a net operating loss carryback to the year 1953 under section 172 of the Internal Revenue Code of 1954.[3] This requires a determination of whether the plaintiff and its predecessor are "the taxpayer" to which section 122(b)(1)(A)[4] allowed the advantage of a carryback.[5]

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[2] 26 U.S.C. (I.R.C. 1939) § 122 (1952 Ed.).

[3] 26 U.S.C. (I.R.C. 1954) § 172 (1952 Ed. Supp. II). Section 381 of the 1954 Code reflects new rules for ascertaining when a successor corporation in certain corporate acquisitions is entitled to carry over or back a net operating loss from or to its predecessor. These rules did not become effective until after the reorganization in the case at bar. No inference is to be drawn from this enactment as to whether tax attributes can be utilized by a successor corporation under pre-existing law. *See Koppers Co., Inc. v. United States*, 133 Ct. Cl. 22, 34 (1955).

[4] Section 122(b)(1)(A) provides as is pertinent:

"If for any taxable year beginning after December 31, 1941, and before January 1, 1950, *the taxpayer* has a net operating loss, such net operating loss shall be a net operating loss carryback for each of the two preceding taxable years * * *." [Emphasis added.]

[5] The Government has strongly urged that Public Law 189, 26 U.S.C. (I.R.C. 1939) § 122 note (1952 Ed.), ch. 249, 61 Stat. 324, so affected the applicable law in this area as to preclude plaintiff from recovery in this case.

P.L. 189 provided, in summary, that if a successor railroad acquired, prior to January 1, 1950, property from a predecessor railroad in a § 77 proceeding it was entitled to use the net operating loss carryover of the predecessor (for years after 1940) "so far as possible as if the predecessor corporation had been made use of in such proceeding instead of the successor corporation." Basing this

In two early cases, the Supreme Court was faced with a successor corporation asking that it be allowed to utilize tax attributes of its predecessor. The first, *New Colonial Ice Co., Inc.* v. *Helvering*, 292 U.S. 435 (1934), involved a voluntary agreement between creditors and stockholders to transfer all assets and liabilities of the old corporation to a new corporation, organized for this purpose. Stating that tax deductions were a matter of legislative grace, and thus needed authorization by specific provision, the Court required the successor to show that it was the "same taxpayer" as its predecessor in order to be entitled to carry over the old corporation's net operating loss sustained prior to the reorganization. In holding the corporations were not the "same taxpayer," the Court stressed that a corporation and its stockholders are separate and distinct legal entities; therefore, there was no continuity of ownership even though the ultimate individuals in interest were the same.

Five years later, in *Helvering* v. *Metro. Edison Co.*, 306 U.S. 522 (1939), a successor corporation had acquired by

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argument on P.L. 189 and its legislative history, the Government asserts that the Congress believed this to be a change in the pre-existing law. This being so, it is contended, the Congress implied there was to be no carryover unless the qualifying reorganization was affected before January 1, 1950. Further, the congressional intent was that there was to be no carryback before or after that date.

However, it must be noted that the reorganization involved in this case does not fall under the express provisions of P.L. 189, since the reorganization took place on March 4, 1954. In addition, the courts are in conflict as to whether P.L. 189 provides a clear congressional intent as to the assumption of corporate attributes in reorganizations not expressly covered by that Act. *Compare Stanton Brewery, Inc.* v. *Commissioner*, 176 F. 2d 572, 577 (2d Cir. 1949), *with Donohue* v. *United States*, 112 F. Supp. 663 (E. D. Mo. 1953). This court in *Koppers Co., Inc.* v. *United States*, 133 Ct. Cl. 22, 35, (1955), found no such clear intent. We therefore feel that the issue in the present case should be based upon something less tenuous than congressional intent gleaned solely from its silence.

merger all the assets and assumed all the liabilities by operation of law of its former subsidiaries. The Supreme Court held that since the transactions were not sales, but rather statutory mergers (or, as in one reorganization, a *de facto* merger); it came within "the principle that the corporate personality of the transferor is drowned in that of the transferee." 306 U.S. at 529. Thus the continuing corporation was treated as the same taxpayer as its predecessor, and assumed the latter's tax attributes.[6]

A reconciliation of these two cases was achieved in *Stanton Brewery, Inc.* v. *Commissioner*, 176 F. 2d 573 (2d Cir. 1949). There a parent holding company survived a statutory merger with its wholly owned operating subsidiary. The court of appeals allowed the resultant corporation the use of an unused excess profits tax carryover of the former subsidiary. It was explained that unlike *New Colonial*, and like *Metro. Edison*, this was not a voluntary transfer of assets by purchase or contract, but a transfer by operation of law. The statutory merger resulted in the taxpayer taking on the obligations, including tax liabilities, of its components by operation of law. It should be noted that

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[6] Carryover provisions prior to the 1954 Code used substantially the same phraseology. See, e.g., Revenue Act of 1924, ch. 234, § 206(b), 43 Stat. 260 ("If, for any taxable year, it appears * * * that *any taxpayer* has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of *the taxpayer* for the succeeding taxable year." [Emphasis added.]); Int. Rev. Code of 1939, § 122(b)(1)(A) (see *supra* note 4). The *New Colonial* case involved the interpretation of § 204(b) of the Revenue Act of 1921, ch. 136, 42 Stat. 227, 231, which was similar to § 206(b) of the Revenue Act of 1924 (*supra*). Thus, cases interpreting the term "the taxpayer," and cases which hold a successor corporation to be in effect the same taxpayer as its predecessor for the purpose of utilizing tax attributes are relevant. *Metro. Edison* concerned the successor's deduction of unamortized bond discount and expense in connection with its retiring certain bonds of corporations which, before a merger pursuant to state law, were its subsidiaries.

the facts in *Stanton Brewery* showed no shift in ownership (the stockholders remained the same), and the business activities did not change after the merger.

In *Koppers Co., Inc.* v. *United States*, 133 Ct. Cl. 22 (1955), this court was first faced with the problem. There a newly formed corporation merged, pursuant to state law, a parent company and its subsidiaries who had filed consolidated tax returns prior to the merger. The merger was tax-free under section 112 of the Internal Revenue Code of 1939. We allowed the surviving corporation's unused excess profits tax credit for its first taxable year to be carried back to reduce the consolidated excess profits net income of the corporations before merger. This was done because we felt that the realistic approach of *Stanton Brewery* best reflected legislative intention. In this respect we could find no reason, nor do we now find any reason, not to allow a surviving corporation in a tax-free merger, which continues the same business with substantially the same ownership, to utilize tax attributes of its predecessors when, but for the merger, the predecessors would have been entitled to take advantage of the privilege in question. We did not deem it essential to discover what legal status the applicable state law gave the components after the merger. Instead we noted that congressional policy since the 1921 Revenue Act showed a more realistic approach to reorganization problems as reflected by the tax-free exchange provisions. "The purpose of these provisions was to allow the corporation to make formal readjustments and carry out ordinary business transactions without disastrous tax consequences." 133 Ct. Cl. at 32. But whether a tax-free reorganization alone would be sufficient reason to apply the *Stanton Brewery* doctrine, or "whether the *New Colonial Ice Company* case should still be held controlling in the non-merger and consolidation cases in view of the changes in legislative policy," it was not necessary to decide, since the plaintiff in *Koppers* resulted from a merger and was not within that category. 133 Ct. Cl. at 33.

Two other decisions from the courts of appeal, prior to the Supreme Court's next attempt to clarify this area, clearly required that a statutory merger be present before a predecessor's tax attributes could be utilized by its successor. See *Gallo Winery v. Commissioner*, 227 F. 2d 699 (9th Cir. 1955); *Newmarket Manufacturing Co. v. United States*, 233 F. 2d 493 (1st Cir. 1956). The court in *Newmarket* expressly distinguished *New Colonial* as not involving a statutory merger. 233 F. 2d at 498.

Now the scene is set for *Libson Shops, Inc. v. Koehler*, 353 U.S. 382 (1957), in which one corporation, the plaintiff, provided management services for 16 separate corporations engaged in selling women's apparel. The latter were operated separately and filed separate income tax returns. These 16 corporations were merged into plaintiff pursuant to state law. Prior to the merger, identical interests owned each corporation; subsequent thereto this was unchanged for plaintiff's stock was issued pro rata in exchange for the stock of the other corporations. Plaintiff argued that it should be allowed to carry over a pre-merger net operating loss of three of its components. These units had continued to suffer losses after the merger, while the other units, and what was now the single enterprise, showed a profit. The question was whether the resulting corporation was "the taxpayer" having the pre-merger losses as required by section 122 of the 1939 Code. The Supreme Court found it unnecessary to discuss the plaintiff's contention that, since a statutory merger was involved, it came within the rule of *Metro. Edison*, and not *New Colonial*. Rather, the Supreme Court refused to allow the carryover because a "continuity of business enterprise" requirement disposed of the case. 353 U.S. at 386. This test required that "the income against which the offset is claimed [must be] produced by substantially the same business which incurred the losses." 353 U.S. at 390. Obviously the income against which the offset was claimed was not earned by the units ("the same business") which

had sustained the loss. Of further importance to the issue before us is the fact that the Supreme Court cited *Stanton Brewery*, *Newmarket*, and *Koppers* as meeting the "continuing enterprise" test. In these three cases, it is apparent that, but for the merger, the old corporation would have been entitled to use the tax privilege involved.

At least one thing is clear from *Libson Shops*, merger alone is not a sufficient basis for allowing the resultant corporation to succeed to its predecessor's tax attributes. The Supreme Court required that tax attributes of a pre-merger corporation could only be utilized to the extent that one could trace that corporation as a unit in the resulting enterprise. Even then the pre-merger corporation's losses could be used only to offset that unit's income or, conversely, the unit's losses could be carried back only to offset the income of its pre-merger form.

But did the Court, in relying on a "continuing enterprise" doctrine, imply that this test could be satisfied even where there was no statutory merger or consolidation? The Court of Appeals for the Seventh Circuit opinion subsequent to *Libson Shops* retained the merger requirement.[7] The Internal Revenue Service's answer was also negative. Revenue Ruling 59-395[8] adopted an allocation procedure in accordance with what *Libson Shops* seemed to require, but such was to be available only after a statutory merger or consolidation.

Nevertheless, the court of appeals in *Donovan Inc.* v. *United States*, 261 F. 2d 470, 476 (1st Cir. 1958), stated that no longer was it satisfactory to distinguish *New Colonial* on the basis of a contrast between statutory merger and other forms of corporate reorganization. In *Donovan*,

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[7] *Pattern Fine Papers* v. *Commissioner*, 249 F. 2d 776, 780 (7th Cir. 1957) (liquidation of subsidiary and parent's acquisition of its assets).

[8] 1959-2 Cum. Bull. 475.

there was a tax-free reorganization (under section 112(b)(6) of the 1939 Code), but *not* a statutory merger, pursuant to which a parent corporation absorbed its wholly owned subsidiary. Consolidated returns had been filed by the corporations prior to the reorganization. The court stressed what we had noted in the *Koppers* case, that the Congress, by adding provisions to the Code to allow certain transactions to be tax-free, recognized that in certain corporate reorganizations there was no realistic economic change. Therefore, the court would not rely on a separate entity concept or merger requirement to preclude the resultant corporation from carrying back a net operating loss sustained after the reorganization by the unit which was the pre-merger subsidiary, to offset the income the subsidiary earned prior to the reorganization.

We interpret *Donovan* as providing that when there is a tax-free reorganization resulting in a "continuing enterprise" (in the sense that the beneficial ownership and business activities are substantially the same after the reorganization as before, and the transferee corporation assumes the liabilities of the transferor)[9] and, but for the reorganization, the old corporation would be entitled to the tax attribute, then the resultant corporation is entitled to utilize the tax attribute.

It is evident from the facts in the case before this court that the reorganization was not a statutory merger; nor was it a *de facto* merger as that term was applied in *Metro. Edison*, since the plaintiff did not assume all the liabilities of its transferor.

But, does the reorganization in question qualify as tax-free, and thus come within the *Donovan* case? "Tax-free reorganization" is the term generally applied to reorgani-

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[9] See *Willingham* v. *United States*, 289 F. 2d 283 (5th Cir. 1961), which included these elements in the "continuing enterprise" doctrine.

zations described in section 112(g)(1) of the Internal Revenue Code of 1939, since 112(b) (3) and (4) provide that "no gain or loss shall be recognized" in transfers pursuant to reorganization. Similarly, section 113(b)(10) provides that "no gain or loss shall be recognized" on the reorganization of corporations, "other than a railroad corporation," in certain receivership and bankruptcy proceedings. However, with respect to the transfer of property of a railroad corporation in a proceeding under section 77 of the Bankruptcy Act, which is the type involved here, section 112(b)(9) only provides that "no loss shall be recognized." Gain, it follows, was intended to be recognized. The reorganization pursuant to which plaintiff resulted, therefore, does not meet the technical requirements of a tax-free reorganization.

It is true that section 113(a)(20) provides that the basis of property acquired under a section 77 railroad reorganization shall be the same in the hands of the transferee corporation as it was in the hands of the transferor. However, even if we adopted the *Donovan* rule that a transferee corporation in a tax-free reorganization may be entitled to its transferor's tax privileges, we certainly cannot say the same should be true merely because a transfer resulted in a substituted basis.

Nor can the plaintiff argue under *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U.S. 179 (1942), that it has a sufficient continuity of ownership to bring it within the "continuing enterprise" rule. From the aforementioned authorities we have demonstrated that aside from this rule, the plaintiff must first show that it is a resulting corporation from a statutory merger or consolidation, or, possibly under the *Donovan* case, at least from a tax free reorganization. This plaintiff has not done, and the fact that it may be a "continuing enterprise" (in the sense of ownership

and business activities) avails it nothing. In addition, plaintiff has not assumed substantially all of its transferor's liabilities, a further element of "continuing enterprise" as we interpret the *Pinellas* case.[7]

[7] We feel it necessary to clarify the rule involved in the *Alabama Asphaltic Limestone Company* case. Aside from meeting the literal requirements of a tax free reorganization provision to qualify under the relevant provision permitting use of the transferor's basis in a tax free reorganization, the taxpayer has also been required to show a continuity of interest between the owners of the resulting corporation and the owners of the corporation prior to reorganization. *See La Tulle v. Scofield*, 308 U.S. 415 (1940). In the *Alabama Asphaltic* case the reorganization literally qualified as tax free under the then applicable Code provision. However, under the bankruptcy plan the old stockholders were wiped out, and the creditors of the old corporation received the new stock. In essence, the Supreme Court held that the creditors of the bankrupt corporation, upon initiation of the bankruptcy proceeding, became the "owners." Thus when the reorganization was finalized and the creditors received the new corporation's stock, the requisite continuity of interest was present. In *Atlas Oil and Refining Corp. v. Commissioner*, 36 T.C. No. 70 (July 14, 1961), cited by plaintiff in its oral argument, a similar situation was involved. There a reorganization under Chapter X of the Bankruptcy Act literally qualified as tax free under § 112 (b) (10) of the 1939 Code. The insolvent corporation's stockholders were eliminated. The Tax Court held that the second mortgage bondholders, who received preferred stock in the new corporation, held the equity interest in the old corporation prior to the finalized reorganization. This satisfied the continuity of interest requirement.

It is apparent that continuity of interest did not become an issue in these cases until a tax free reorganization provision was literally met. They do not hold that once a continuity of interest is found the reorganization is tax free. We do not feel that the rules developed in reference to continuity of interest in the *Alabama Asphaltic* sense are equally applicable to a determination of continuing ownership in the *Libson Shops* sense.

[8] See also *Willingham v. United States*, *supra* note 9. This case illustrates that, even apart from the issue of whether a statutory merger is a condition precedent to the privilege of assuming a predecessor's tax attributes, where an old corporation's charter is

The plaintiff, in asserting its claim, has primarily relied on the decision of this court in *Wabash Railroad Co.* v. *United States*, 143 Ct. Cl. 316 (1958). The issue in that case can be seen from our discussion at page 321:

> The defendant contends that [taxpayer] was not entitled to use its bankrupt predecessor's unused excess profits carryovers until the date of the enactment of Public Law 189 in 1947 and that consequently, from March 15, 1943 (the due date of [taxpayer's] excess profits tax return for the calendar year 1942), to July 15, 1947 (the day on which Public Law 189 became law), [taxpayer] was, under the law as it then existed, actually liable for the excess profits tax • • • [which was potentially due until the effective date of the Act].

The taxpayer in *Wabash*, a successor railroad in a section 77 proceeding as is the plaintiff here, desired a refund of the interest it paid on the "potential deficiency" assessed for its taxable year of 1942. If taxpayer was not actually liable for the excess profits tax in 1942, then there would not be a "potential deficiency" and, of course, no interest would be due. Taxpayer would not have been liable for such tax in 1942, if at that time it had the right to carry over an excess profits tax credit of its predecessor arising in the predecessor's taxable years of 1940 and 1941, which were immediately prior to the effective date of the reorganization on December 31, 1941.

One ground on which our opinion rested, as is indicated by the concurring opinion at pages 329 and 330, was that the Congress in passing Public Law 189 (the latter is more

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retained by a resultant non-railroad corporation in a proceeding under the Bankruptcy Act, the reorganization does not necessarily meet the "continuing enterprise" test of *Libson Shops*. In disallowing the new corporation's use of a net operating loss carryover of the old corporation, the court gave as one reason the fact that the successor had not assumed all the liabilities of its transferor.

fully explained in footnote 5 of the present opinion) intended "to give to the successor corporation the right to avail itself of the unused excess profits credit of the predecessor corporation as of the time when the successor corporation was required to file its income tax return." Thus, "no deficiency resulted, and, therefore, no interest is due."

But, and of particular relevancy to the case at bar, we also held alternatively that successor railroad, like plaintiff, was, even prior to the passage of Public Law 189, the same taxpayer as its predecessor for purposes of utilizing its predecessors excess profits credit tax carryover. (For this reason also, no "potential deficiency" ever existed, and, therefore, no interest was due.) Although we noted that the Commissioner of Internal Revenue had ruled that the transaction was not tax free, and that the reorganization did not meet the literal requirements of the applicable Code provisions, we nevertheless treated it as essentially a tax-free reorganization. As a basis for this construction, we interpreted the *Alabama Asphaltic Limestone Co.* case as holding that when a continuity of ownership was found, a resultant corporation in a bankruptcy reorganization which did not literally qualify as a tax free reorganization could be treated as a tax-free reorganization. Upon reconsideration of this point, we have decided we were in error in our application of the *Alabama Asphaltic Limestone Co.* case. The reasons for this are discussed in footnote 10 of this opinion.

Also, when applying the "continuing enterprise" requirement of *Libson Shops*, we assumed that the taxpayer in *Wabash* had taken over *all* the obligations of its predecessor corporation. Whether or not this element of the "continuing enterprise" test was satisfied in *Wabash*, it is apparent that it is not satisfied in the case presently before us.

In this reorganization the old stockholders were wiped out; they were no longer in the business; the new stock-

holders were some of the former creditors of the business. The same business was being carried on, but by a different group of people. Thus, continuing ownership is not present, and, hence, the successor corporation cannot carry back its losses to offset the gain realized by the old corporation.

In light of the foregoing, we are constrained to hold that the plaintiff is not entitled to recover and its petition will be dismissed.

It is so ordered.

DARR, *Senior District Judge*, sitting by designation; DURFEE, *Judge*; LARAMORE, *Judge*; and WHITAKER, *Judge*, concur.

FINDINGS OF FACT

The court, having considered the evidence, the stipulation of the parties, and the briefs and argument of counsel, makes findings of fact as follows:

1. The plaintiff seeks to recover from the United States the sum of $286,391.13 together with interest thereon as provided by law, which sum represents income tax plus deficiency interest thereon collected from plaintiff by the Commissioner of Internal Revenue in respect of the income tax liability of plaintiff's predecessor corporation, Wisconsin Central Railway Company (hereinafter called predecessor), for the calendar year 1953.

2. An income tax return for predecessor for the calendar year 1953 was duly filed with the District Director of Internal Revenue at St Paul, Minnesota, on September 14, 1954. No tax liability was reported thereon. Thereafter, the Commissioner determined a deficiency of $175,948.79, and that amount, together with $16,220.19 interest, was paid by plaintiff on December 29, 1955. Thereafter, the Commissioner determined a further deficiency of $77,711.19, and that amount, together with $19,581.09 interest, was

paid by plaintiff on June 6, 1958. In November 1958, the Commissioner refunded $3,070.13 of the interest theretofore paid by plaintiff. Plaintiff has thus paid $253,659.98 tax and $32,731.15 interest, or a total of $286,391.13, in respect of predecessor's liability for 1953.

3. By agreement timely executed between plaintiff and the Commissioner, the period for assessment of income taxes with respect to predecessor's calendar year 1953 was extended to June 30, 1958. On June 27, 1958, and within the time prescribed by law, plaintiff filed a claim for refund of $253,659.98 income tax and $35,801.28 deficiency interest thereon paid by plaintiff in respect of predecessor's income tax liability for the calendar year 1953. The allegations in the claim are denied by the defendant. Under date of February 18, 1959, the Commissioner mailed to plaintiff by registered mail a notice of the complete disallowance of the claim.

4. Predecessor was a corporation organized and existing under the laws of the State of Wisconsin. Until March 1, 1954, it was engaged in business as a common carrier by rail.

5. Predecessor was in receivership from December 2, 1932, to September 30, 1944. From September 30, 1944, to March 1, 1954, predecessor was in trusteeship in a reorganization proceeding under section 77 of the Bankruptcy Act, as amended. Throughout both proceedings, predecessor was under the jurisdiction of the United States District Court for the District of Minnesota.

6. A plan of reorganization for predecessor was prepared. The plan was approved by the Interstate Commerce Commission in its second supplemental order of September 15, 1952 (282 I.C.C. 567), and by the District Court in an order entered April 17, 1953. The plan was duly confirmed by the District Court by order entered October 1, 1953. The plan included the following provisions:

Reorganized Company

The term "reorganized company," as used herein, means the corporation, whether the debtor or a new corporation, which shall issue the new securities provided for in the plan. The reorganization managers may determine, with the approval of the court, whether a new corporation shall be organized or whether the new securities shall be issued by the debtor, with appropriate amendments to its certificate of incorporation. The reorganized company, if other than the debtor, shall be incorporated under the laws of such State as the court may direct. All property of the debtor and of its trustee shall be transferred to the reorganized company subject to and in accordance with the plan.

7. Pursuant to the plan, reorganization managers were designated. The reorganization managers determined that the "reorganized company" should be a corporation of the State of Minnesota under the name of Wisconsin Central Railroad Company. Their determination was approved by the District Court by an order entered February 19, 1954. Plaintiff was organized on February 19, 1954, under the laws of the State of Minnesota, by the reorganization managers acting pursuant to the order of the District Court, for the purpose of carrying out the plan of reorganization. From February 19, 1954, to March 1, 1954, plaintiff conducted no business and had no assets other than $1,000.00 cash paid in for stock upon its organization.

8. As of 12:01 a.m. on March 1, 1954, plaintiff acquired all of the property of predecessor, pursuant to the plan of reorganization and pursuant to the consummation order and final decree of the District Court, entered February 26, 1954. Since March 1, 1954, plaintiff has operated as a common carrier by rail.

9. The consummation order and final decree provided in part as follows:

3. *Transfer of Property* Except as otherwise provided in this order, at 12:01 A.M., Central Standard Time, on March 1, 1954 (referred to in this order as the Consummation Date), all of the business and affairs of the Debtor, and all right, title, and interest of the Debtor and the trustee of its property, in and to its property of every kind and description, whether real, personal, or mixed, whether tangible or intangible, and whether of present or future interests, and all rights, privileges, and franchises of the Debtor shall, the laws of any state or the decisions or orders of any state authority to the contrary notwithstanding, vest in and become the absolute property of Wisconsin Central Railroad Company (referred to in this order as the New Company), a corporation organized and existing under the laws of the State of Minnesota, free and clear of all rights, claims, interests, liens, and encumbrances of the creditors of the Debtor and of the holders of the shares of capital stock of the Debtor, and except as otherwise provided in this order the Debtor shall thereupon be released and discharged forever from all of its debts and liabilities, whether or not the same shall have been presented or allowed as claims in these proceedings. The New Company and its property shall also be free and clear of all such rights, claims, interests, liens, encumbrances, debts, obligations, and liabilities except as otherwise provided in this order.

21. *Assumption and Payment of Taxes Due to the United States.* The New Company shall on the Consummation Date assume liability for and pay in full in due course any and all taxes due the United States of America from the Debtor the receivers, the bankruptcy trustees, or any of them, subject to the statutes

of limitations normally applicable to the assessment and collection of such taxes; * * *

10. As a result of the reorganization plan and consummation order and final decree, the plaintiff corporation assumed: all executory contracts made by the receivers or trustees in the operation of the predecessor's property; all claims against the predecessor entitled to priority over its respective mortgages; liabilities incurred in the operation of predecessor's property by the receivers prior to the reorganization proceedings or by the receiver or the trustees of the property of the predecessor during the reorganization proceedings; taxes (other than those of the United States of America) levied, assessed, or accrued against the predecessor or the bankruptcy trustee; all approved but unpaid costs of administration and reorganization; and obligations of more than $5,000,000 for conditional sales agreements and equipment trusts. Bonded indebtedness under three different mortgages (totaling approximately $56,500,000) was not assumed; but was discharged through issuance of new bonds (totaling approximately $35,000,000) and new common stock.

11. Unsecured claims (totaling approximately $9,000,000) were not assumed by the plaintiff. The interest of the preferred and common stockholders (of par value totaling approximately $27,000,000) was eliminated.

12. Predecessor's final taxable year was the period beginning January 1, 1954, and ending February 28, 1954. Plaintiff's first taxable year was the year beginning March 1, 1954, and ending December 31, 1954. In the period ended February 28, 1954, predecessor had a net operating loss which was allowed as a carryback to the year 1952.

13. The net income of predecessor for the calendar year 1953 was $522,656.84 before the allowance of any net operating loss deduction. For the taxable period March 1, 1954, to December 31, 1954, plaintiff had a net operating

loss in an amount sufficient to eliminate all net income of predecessor for 1953 if allowed as a net operating loss carryback to 1953.

14. Plaintiff is the sole owner of the claims sued upon and that no assignment or transfer thereof, or any part thereof, or interest therein, has been made.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover and its petition is therefore dismissed.